Supreme Court, U. S.
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No. 79-1721

In the
Supreme Court of the United States
October Term, 1979

CARLE FOUNDATION, an Illinois Not for Profit corporation,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

BRIEF OF ILLINOIS HOSPITAL ASSOCIATION AMICUS CURIAE

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The Illinois Hospital Association submits herewith its brief as *amicus curiae* in support of the Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit heretofore filed herein by Carle Foundation, an Illinois not for profit corporation, Petitioner. Counsel for both parties to this cause have consented to the filing of this brief and attached hereto as Appendix 1 and 2 are copies of such written consents.

STATEMENT OF INTEREST

The Illinois Hospital Association is a statewide association of Illinois hospitals with a membership of 287 hospitals. Of these, 42 are Governmental in nature, 12 are Proprietary and the balance of approximately 233 are Not for Profit hospitals substantially all of whom are tax exempt as exclusively charitable pursuant to Chapter 26 U.S.C. Section 501(c)(3). The Petitioner, Carle Foundation, is a hospital very like the other 233 members of the Illinois Hospital Association since it is a not for profit corporation with a Sec. 501(c)(3) tax exemption.

The judgment and opinion of the Court of Appeals for the 7th Cir. to which the petition for *certiorari* is directed, held that certain sales of pharmaceuticals by Carle Foundation Hospital are taxable as an unrelated trade or business pursuant to 26 U.S.C. §§511-513.

It is the position of the Illinois Hospital Association that the decision of the Court of Appeals for the 7th Cir. should be reviewed by this court since it has reaching implications and transcends the interests of the parties hereto. If permitted to stand, the opinion will have a chilling effect on Illinois hospitals organized in a manner similar to Carle Foundation, particularly in their effort to furnish a broad community hospital service at a reasonable cost. The opinion of the 7th Cir. unduly restricts the non-taxable activities of tax exempt hospitals and will inhibit their effort to achieve stability and to furnish community-wide medical and hospital services in an efficient and economical manner.

ARGUMENT

THE DECISION OF THE COURT OF APPEALS FOR THE 7TH CIRCUIT FINDING THAT SALES OF PHARMACEUTICALS BY A TAX EXEMPT HOSPITAL TO A FOR PROFIT OUTPATIENT CLINIC AND DIRECTLY TO OUTPATIENTS CONSTITUTES AN UNRELATED TRADE OR BUSINESS AND IS THEREFORE TAXABLE UNDER 26 U.S.C. SECS. 511-513 HAS THE EFFECT OF CONSTRICTING THE OPERATION OF TAX EXEMPT HOSPITALS TO A DEGREE INCONSISTENT WITH THEIR APPROVED PURPOSES, AND IS INCONSISTENT WITH THE INTENT OF SECS. 511-513 OF THE INTERNAL REVENUE CODE AND IS CONTRARY TO CONGRESSIONAL RECOGNITION OF THE NECESSITY OF TAX EXEMPT HOSPITALS ENGAGING TO SOME EXTENT IN ACTIVITIES WHICH COULD BE VIEWED AS THE CONDUCT OF A TRADE OR BUSINESS.

Every hospital in this country is under tremendous pressure to do two things; first, to furnish hospital care in as broad a manner as possible to the area or community that it serves while bringing to such care all the myriad medical miracles and developments achieved by modern medicine and secondly, to furnish this expanded care in as economical and efficient manner as possible.

In order to achieve the foregoing two purposes, hospitals have not only expanded in-patient facilities but have undertaken to furnish, on an ever increasing scale, out-patient services. The importance of out-patient services is not only in easing for the patient the strictures involved in in-patient diagnosis, care and treatment but of paramount concern in the furnishing of hospital services in a more economical and efficient manner. For this

reason hospitals, such as Carle Foundation, have made the most feasible arrangements possible in order to extend its services on a broad basis. Clearly, from a hospital's standpoint, sales of pharmaceuticals to an out-patient clinic, whether organized for profit or not for profit, is in fulfillment of the hospital's primary purpose, which is the furnishing of hospital care to the community. The decision of the Court of Appeals in this case focused almost entirely on such irrelevant factors as that the hospital and clinic are separate legal entities and that the sales to the clinic yielded some profits to the hospital. This analysis by the 7th Cir. completley ignores the fact that the pharmacy was primarily a hospital pharmacy located on the hospital premises with the out-patient clinic a part of the hospital's medical complex. The circumstance that the clinic was a separate for profit entity and the hospital pharmacy attained some profit due to the sales is not as significant as the fact that the clinic functioned as the out-patient facility of the hospital and furnishing it with pharmaceuticals was in direct furtherance of the hospital's primary exempt purpose.

It is apparent from the facts that Carle Foundation was selling pharmaceuticals to the clinic primarily because the clinic functioned as its out-patient facility and certainly "contributed importantly" to the accomplishment of the hospital's exempt purposes.

All not for profit tax exempt hospitals in Illinois do not operate exactly in the same manner. Without exception, however, they are all engaged in furnishing in-patient and out-patient facilities on as broad a basis as possible in an efficient and economical manner as possible. The effect of the ruling of the 7th Cir. in this case is to increase the cost of furnishing out-patient services to the

extent that a tax must be paid and to, in general, inhibit the broad purposes of a charitable hospital in furnishing health care to the community it serves.

The primary reason for the adoption by Congress of Secs. 511-513 of the Internal Revenue Code was to prevent tax exempt organizations from competing unfairly with tax paying competitors. In the case of a hospital pharmacy such as the one operated by Carle Foundation, there is literally no competition with other pharmacies involved. The Carle pharmacy served almost exclusively hospital in-patients and out-patients and did not purport to serve the public generally. There was no direct street access to the Carle pharmacy and it was an integral part of the hospital complex. This is the usual arrangement with hospital pharmacies and their primary function is to assist the hospital in fulfilling its exempt purposes.

A hospital, in some ways, is a world in itself and this is particularly true of activities involving the furnishing of supporting services such as pharmaceuticals. A hospital pharmacy is not competing with the corner drugstore and the thrust of Secs. 511-513 of the Code is not aimed at such an activity.

The 7th Cir., in its opinion in this case, inappropriately equated the Carle pharmacy with a for profit competitor when in fact there was no competitor and there could have been none due to the method of operation of the Carle pharmacy.

There has been Congressional recognition of the need for tax exempt hospitals to engage in activities which might ordinarily be considered engaging in a trade or business and Congress, in one aspect, has given its specific approval to such activities. This is evidenced by Con-

gressional enactment in 1968 of §501(e) of the Internal Revenue Code relating to cooperative hospital services by permitting the organization by §501(c)(3) hospitals, together with governmental institutions, of an organization furnishing such services as data processing, purchasing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center and personnel (including selection, testing, training and education of personnel) services. An organization so formed under §501(e) is expressly recognized as an organization operated exclusively for charitable purposes. The object, of course, was to enable hospitals acting in a cooperative manner to furnish services to tax exempt hospitals that might otherwise be considered engaging in a trade or business. It is respectfully submitted that just as Congress has recognized the growing problems of tax exempt hospitals in furnishing necessary services so too should the courts appreciate that hospitals should be encouraged to broaden their facilities, including particularly out-patient services, and their efforts to do so should not be inhibited by a narrow restriction of a hospital's legitimate purpose. The decision of the 7th Cir. in this case certainly narrows the permitted activities of tax exempt hospitals and this is clearly not in the public interest nor is it consistent with the thrust of the Internal Revenue Code.

CONCLUSION

The Illinois Hospital Association as *amicus curiae* respectfully urges the court to grant the petition for *certiorari* and thereafter to reverse the decision of the Court of Appeals for the 7th Circuit in this case.

Respectfully submitted,

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APPENDIX 1

UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE SOLICITOR GENERAL
Washington, D.C. 20530

May 7, 1980

Harry L. Kinser, Esq.
McLaughlin, Kinser & Bryant
135 South LaSalle Street
Chicago, Illinois 60603

Re: Carle Foundation v. United States,
(October Term, 1979-No. 79-1721)

Dear Mr. Kinser:

In accordance with the request in your letter of May 2, 1980, I hereby consent to your filing a brief *amicus curiae* in support of the petitioner in the above-captioned case on behalf of the Illinois Hospital Association.

Sincerely,

WADE H. MCCREE, JR.
Solicitor General

cc: Honorable Michael Rodak, Jr.
Clerk,
United States Supreme Court

APPENDIX 2

McDERMOTT, WILL & EMERY
111 West Monroe Street
Chicago, Illinois 60603
312-372-2000

May 7, 1980

Mr. Harry L. Kisner
McLaughlin, Kinser & Bryant
135 South LaSalle Street
Suite 1200
Chicago, Illinois 60603

Re: Carle Foundation
vs.
United States of America

Dear Mr. Kinser:

You have requested our consent to file an amicus brief with the Supreme Court in connection with the above-captioned case. Please be advised that we consent to the preparation and filing of this brief.

Sincerely,

/s/ John S. Pennell
John S. Pennell

JSP: km
cc: Michael Rodak, Jr.
Clerk, Supreme Court